economic trends

February 2013

Alberta's economic expansion continues

This edition of Trends is taken from the Third Quarter Economic Statement released on February 19th, 2013. The InFocus highlights the recent changes to Canada's Economic Accounts.

In a sluggish global economy, Alberta has continue to excel. The provincial economy grew by an estimated 3.8% in 2012, in line with the budget forecast and roughly double the national increase. Alberta led the provinces in employment growth during 2012; the 2.7% increase was exactly in line with the budget forecast.

Growth in real Gross Domestic Product (GDP) is now expected to downshift to a more sustainable rate of 2.9% in 2013 (Figure 1). The moderation reflects weaker market conditions for the province's oil industry. Rising oil production has bumped up against pipeline constraints in North America, forcing Alberta producers to take steep price discounts relative to oil produced elsewhere. This has had negative impacts on Alberta's and Canada's economy.

Other developments have been more favourable than expected at Budget 2012. Soaring net migration has boosted Alberta's housing market, contributed to a surge in consumer spending, and helped keep wage pressures contained. Households drove much of Alberta's economic growth in the second half of 2012, and are expected to play a key role again in 2013.

Alberta's nominal GDP, the value of output in current prices, has been hit much harder by lower energy prices than real economic activity.

Key Indicators — All indicators seasonally adjusted unless otherwise indicated.

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	January	2,175	1.9%
Unemployment Rate	January	4.5%	-0.5 p.p.
CPI Inflation	January	-0.5%	-3.4 p.p.
Retail Sales	December	$5.7B	+1.9%
Housing Starts (annualized)	January	29,336	+12.1%
Rigs Drilling (unadjusted)	February	422	-8.1%
Manufacturing Shipments	December	$5.8B	-9.0%
Exports (unadjusted)	December	$7.5B	-13.7%

Source: Statistics Canada, CAODC, CMHC. p.p.= percentage points.

Alberta Business Sector

After a sharp run-up in late 2011 and early 2012, most indicators of business activity and output have moderated. Lower energy prices have contributed to a pullback in drilling activity (Figure 2) as well as weaker growth in oil exports and manufacturing shipments.

Oil industry encounters pipeline constraints and price discounts

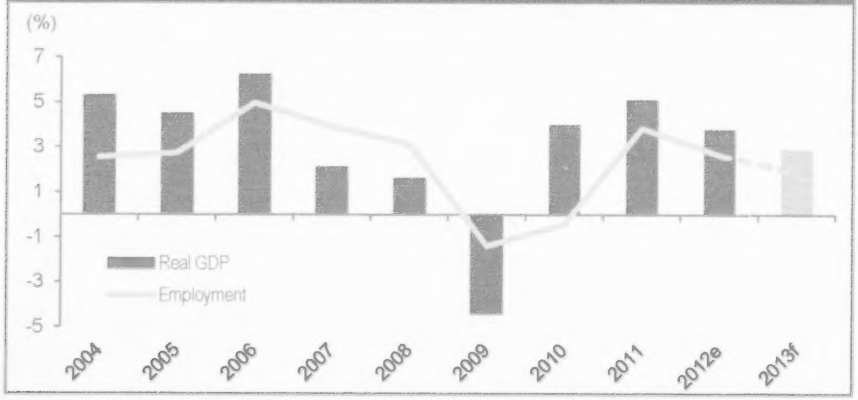
Rising oil sands production continues to add significantly to Alberta's economic growth. However, oil prices have softened and Alberta producers are facing steep price discounts on their production. WTI oil prices are expected to average US$91.82/barrel this fiscal year, down from US$92.50 at second quarter and US$99.25 at *Budget 2012*. A number of factors have weighed on the WTI price including: rising production, a lack of takeaway capacity to alternate markets, and weak demand due to the recession in the Eurozone and a slowdown in emerging markets.

A softer outlook for prices has dampened growth expectations for business investment in 2013 relative to *Budget 2012*. Oil sands investment is still expected to proceed, but at a more cautious pace and with an emphasis on containing costs.

Natural gas prices are forecast to remain depressed at $2.26/GJ in 2012-13, reflecting a glut of North American supply.

Lower energy prices have negatively impacted corporate net operating surplus (a measure of profits), which is estimated to have dropped by over 6% in 2012.

Figure 1: Growth in Alberta Real Gross Domestic Product and Employment



Source: Statistics Canada

Strong conditions in other industries

Business conditions in non-energy sectors have generally been favourable in Alberta. Building construction rebounded in 2012, and permit data suggest further improvement in 2013. In the agricultural industry, cash receipts are rising, and producers are expected to continue to benefit from strong prices and rising yields. In the forest product sector, sawmills have been ramping up production to near record levels, which partly reflects improvement in the US housing sector.

Business cost pressures are expected to stay fairly contained in the near term, as soaring migration limits growth in labour costs and interest rates stay near record lows.

Alberta Household Sector

Households to remain key economic drivers in near term

Economic activity in Alberta has shifted from businesses to households heading into 2013. A strong labour market has attracted people from other provinces and countries; net migration hit levels not seen since the early 1980s in the third quarter of 2012. Population growth continues to far outpace the rest of Canada, and the gap has widened markedly (Figure 3).

Rising net migration and a robust labour market have boosted consumer spending, with retail sales rising 7.6% in 2012, the highest among all provinces and triple the national average. These factors have also supported gains in the housing market, with housing starts up 30% last year.

The momentum from the household sector will support Alberta's economic expansion again in 2013. The labour market is expected to remain strong, with the unemployment rate forecast to stay near current levels and employment expanding at a healthy pace of 1.9%. New jobs will continue to draw migrants, supporting a population growth forecast of 2.6%.

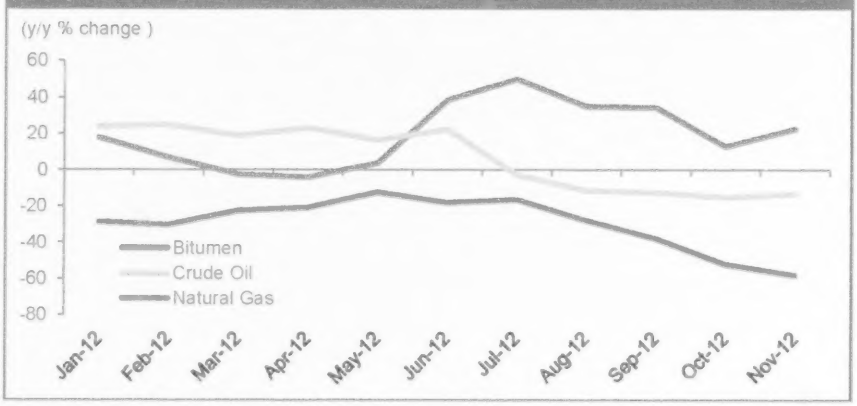
Labour market and population gains will drive another healthy increase in real consumer spending in 2013, and housing starts are also expected to remain strong.

Inflation has been weak despite strength in the Alberta economy. Consumer price inflation averaged 1.1% in 2012 and turned negative for the first time in over three years with January's -0.5% reading. The fall in consumer prices was mainly due to a 30% drop in electricity prices from the record high set in January 2012. In 2013, inflation pressures are expected to stay subdued.

Risks to the economic outlook

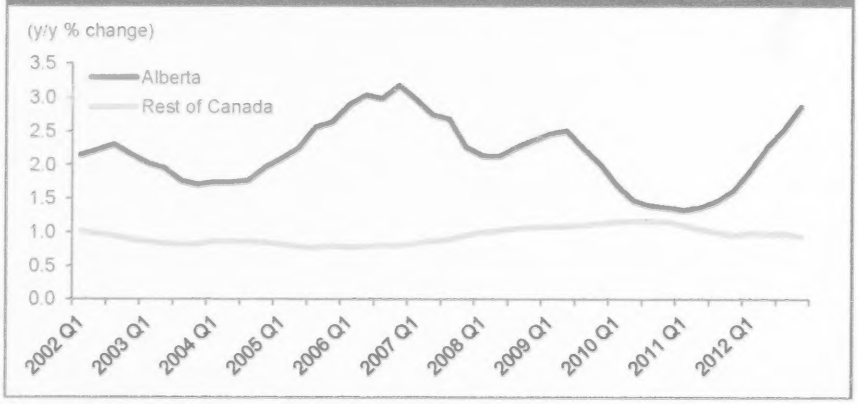
- Pipeline constraints could weaken oil prices more than expected. With little spare pipeline capacity, even minor disruptions to transportation and refining have a large impact on oil prices.
- After the tax deal in January, more fiscal hurdles loom in the US, including agreement on spending cuts, passing a new budget and extending the debt ceiling in May. Failure to overcome these hurdles would hurt the US economy, with negative implications for Alberta and Canada.
- A deepening of the recession in Europe could contribute to another slowdown in emerging markets, weighing on commodity prices.
- Upside risks to the outlook include the announcement of new pipeline capacity, a timely resolution to the fiscal challenges in the US, and progress in the Eurozone.

Figure 2: Alberta Meters Drilled



Source: Energy Resource Conservation Board

Figure 3: Population Growth



Source: Statistics Canada

Enhancing Measures to Evaluate the Economy

Economists rely on economic data to analyze historical trends and forecast future activity. Some of the most important economic indicators, such as economic growth, are determined through the Canadian System of National Accounts (CSNA). The CSNA recently underwent a historical revision to reflect changes in the economy as well as new and improved sources of data. This InFocus discusses some of the more significant changes under the revision.

The Importance of the Historical Revision

Periodic historic revisions of the national accounts are required in order to improve the way the statistics are estimated and reflect recent changes to international standards, which are developed jointly by the World Bank and other international organizations. The latest historic revision introduced new economic terms and concepts that better reflect the changing economy, as well as new and improved sources of data.

What is the Canadian System of National Accounts?

The CSNA is the accounting system Statistics Canada uses to measure the economic activity of Canada and each of the provinces. This system is based on an international standard that allow for meaningful comparisons across countries. The CSNA accounting framework captures key components of the economy, including output, income and expenditure, financial flows, and the balance of payments. Information from the CSNA is used to estimate statistics on GDP, productivity, government debt, and other key economic indicators. In October 2012, Statistics Canada starting releasing historically revised CSNA data. National data have been revised back to 1981, while provincial revisions are available to 2007. Provincial series dating back to 1981 will be available later this year.

How was GDP Impacted by the Revision?

The level and growth rate of gross domestic product (GDP) did not change substantially as a result of the historical revision (Chart 1). However, certain GDP components underwent significant conceptual changes. The presentation of GDP components has also been substantially modified.

Key Revisions to the CSNA

Redefined Institutional Sectors

One of the most important improvements to the CSNA was the development of new institutional sectors. Rather than four highly aggregated sectors, there are now six distinct institutional sectors. The persons and unincorporated businesses sector has been separated into a household sector and a separate non-profit institutions serving households (NPISH) sector. The former corporate sector has been separated into two: non-financial corporations and financial corporations. The general government sector now includes aboriginal general governments, which were previously grouped with households and NPISH. The non-resident sector was the only institutional sector that was not revised.

A key benefit of these changes is that there now exists a defined household sector, which provides a meaningful measure of household activity.

Income-based GDP Components

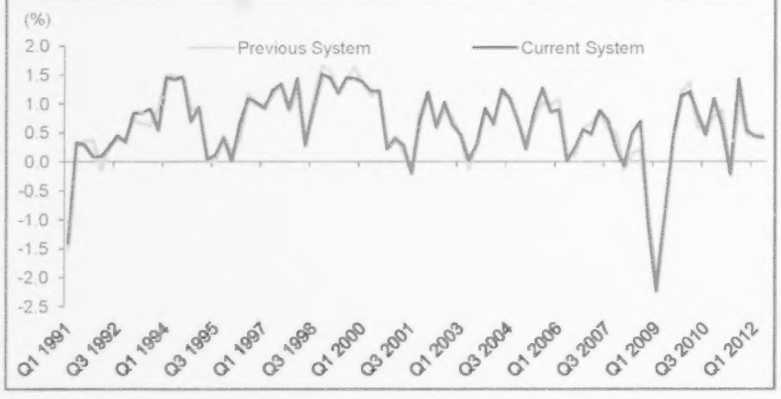
GDP can be measured on an income basis, which shows how total income flows to different sectors of the economy, or an expenditure basis, which tracks how expenditures flow from different sectors of the economy.

The presentation of income-based GDP components underwent substantial changes, largely due to new data sources and improvements in estimation methods. In addition to the components discussed below, net taxes on production, products and imports remain components of income-based GDP.

- **Compensation of Employees**

  To align with international terminology "Compensation of Employees" has replaced the term "labour income", although there was no corresponding conceptual change. It includes wages and salaries, plus employers' social contributions.

Chart 1: Comparison of Real GDP Growth Rates - Canada



Source: Statistics Canada

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- **Gross Operating Surplus**

  Corporation profits before taxes has been combined with other items such as interest and miscellaneous investment income under a new term called "Net Operating Surplus: Corporations". Adding consumption of fixed capital for corporations, general governments and NPISH to this new measure yields Gross Operating Surplus.

  Despite the changes, a comparison of corporation profits before taxes and net operating surplus reveals that growth in these two measures generally follow the same trend (Chart 2).

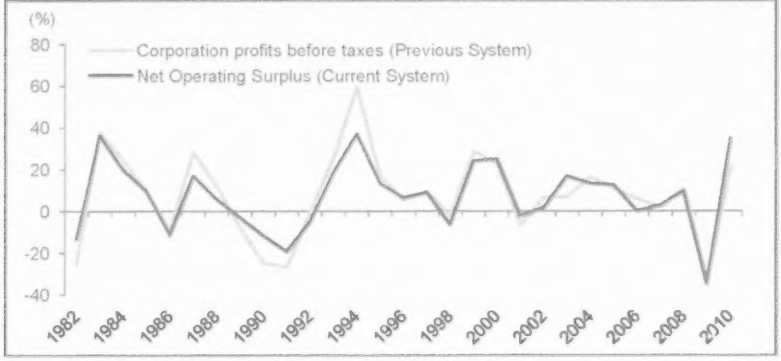
- **Gross Mixed Income**

  This category includes net mixed income of households and unincorporated businesses, as well as consumption of fixed capital for unincorporated businesses. This is a major improvement, as consumption of capital can now be separated between corporations and unincorporated businesses. As a result, contribution of capital to GDP can now be distinguished between corporations and households.

Sources of Income: Household Sector

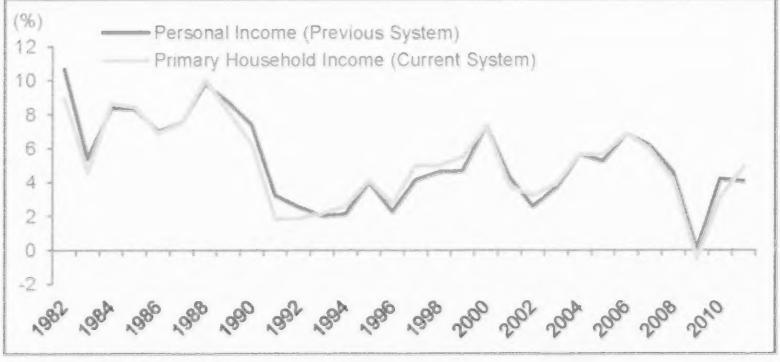
With the creation of a defined household sector, a comprehensive breakdown of income sources specifically for the household sector is now possible. Referred to as "Primary Household Income", this category summarizes the sources of income for households, including compensation of employees, mixed income, and property income. While "primary household income" is somewhat different than the previous "personal income" measure, Chart 3 shows that the historical growth rates of the two measures are very similar.

Chart 2: Annual Growth Rates: Corporation Profits Before Taxes vs. Net Operating Surplus - Canada



Source: Statistics Canada

Chart 3: Annual Growth Rates: Personal Income vs. Primary Household Income - Canada



Source: Statistics Canada

Expenditure-Based GDP Components

There were also changes to come of the main components of expenditure-based GDP. The presentation has not changed considerably, but some of the sub-components have been revised to reflect improved methodologies.

- **Final Consumption Expenditure**

  "Personal expenditure on consumer goods and services" is now split into households and NPISH final expenditure. Expenditure for general governments is also now available.

- **Gross Fixed Capital Formation**

  Capital formation data specific to NPISH are now available. "Business gross fixed capital formation" includes a new subcategory, "intellectual property products", which is made up of research and development activities (R&D), software and mineral exploration. Under the previous system, software was grouped with machinery and equipment, while mineral exploration was grouped with non-residential construction. R&D, along with military weapons systems, are now considered investments rather than expenditures. As well, the new accounting methodology for valuing fixed capital based on a replacement, rather than historical, cost basis has resulted in faster depreciation for fixed capital.

Conclusion

The historical revision was a large undertaking for Statistics Canada. In the future, Statistics Canada is planning to move away from a one-time, large scale approach to historical revisions and implement them on a more frequent basis. Planned comprehensive revisions will continue in 2014 and 2017.

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